CENTRALE BANK VAN ARUBA

Press Release

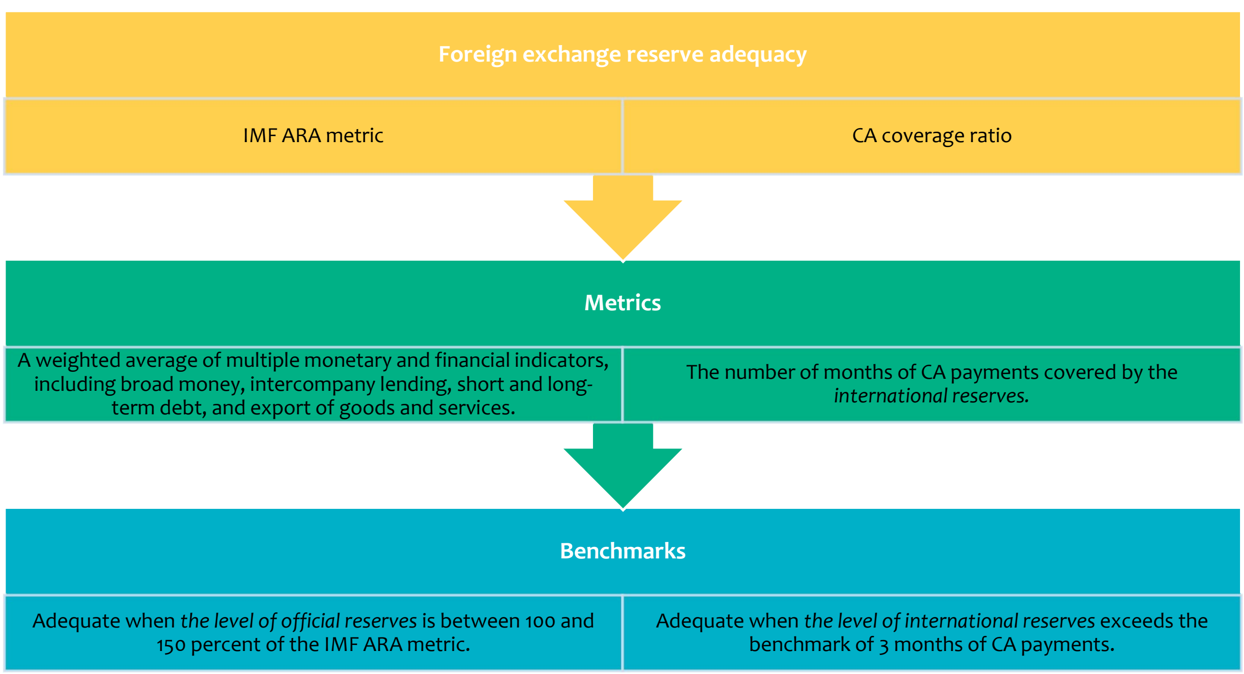
Further tightening of monetary policy: increase in the reserve requirement

On October 14, 2021, the Monetary Policy Committee of the Central Bank of Aruba decided to further increase the reserve requirement by 1 percentage point (i.e., from 10.0 percent to 11.0 percent) as of the 1st of November 2021. Hereto, the following information and monetary policy analysis was considered:

1. Benchmarks to monitor and maintain foreign exchange reserve adequacy

To maintain monetary stability and safeguard the fixed exchange rate between the Aruban florin and the US dollar, adequate foreign exchange reserve buffers are essential. The Centrale Bank van Aruba (CBA) utilizes two key benchmarks to monitor and assure adequate levels of reserves: the International Monetary Fund (IMF) Assessing Reserve Adequacy (ARA) metric and the current account (CA) coverage ratio (Figure 1).

Figure 1. Foreign exchange reserve adequacy benchmarks.



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International reserves are defined as the sum of official reserves under management by the CBA in addition to the foreign exchange reserves managed by local commercial banks. In general, official reserves are defined as external assets that are: (i) readily available to and controlled by central banks for meeting balance of payments financing needs, (ii) serve as a basis for foreign borrowing and (iii) for maintaining confidence in the (domestic) currency and the economy. More importantly, due to our fixed exchange rate that is pegged to the US dollar, official and international reserves serve to maintain the value of the Aruban florin at a fixed level. Consequently, adequate reserves are of critical importance for maintaining monetary and financial stability.

The level of official reserves held by the CBA is considered to be suitable when it is between 100 and 150 percent of the IMF ARA metric. This reserve adequacy metric measures *the level of official reserves* by benchmarking this against a weighted average of multiple monetary and financial factors. These includes broad money, intercompany lending, short and long-term debt, and export of goods and services. Meanwhile, the current account coverage ratio measures the number of months of current account (CA) payments covered by the international reserves and considers *the level of international reserves* to be proper when it exceeds the traditional benchmark of 3 months of CA payments.

2. Recent Monetary Developments

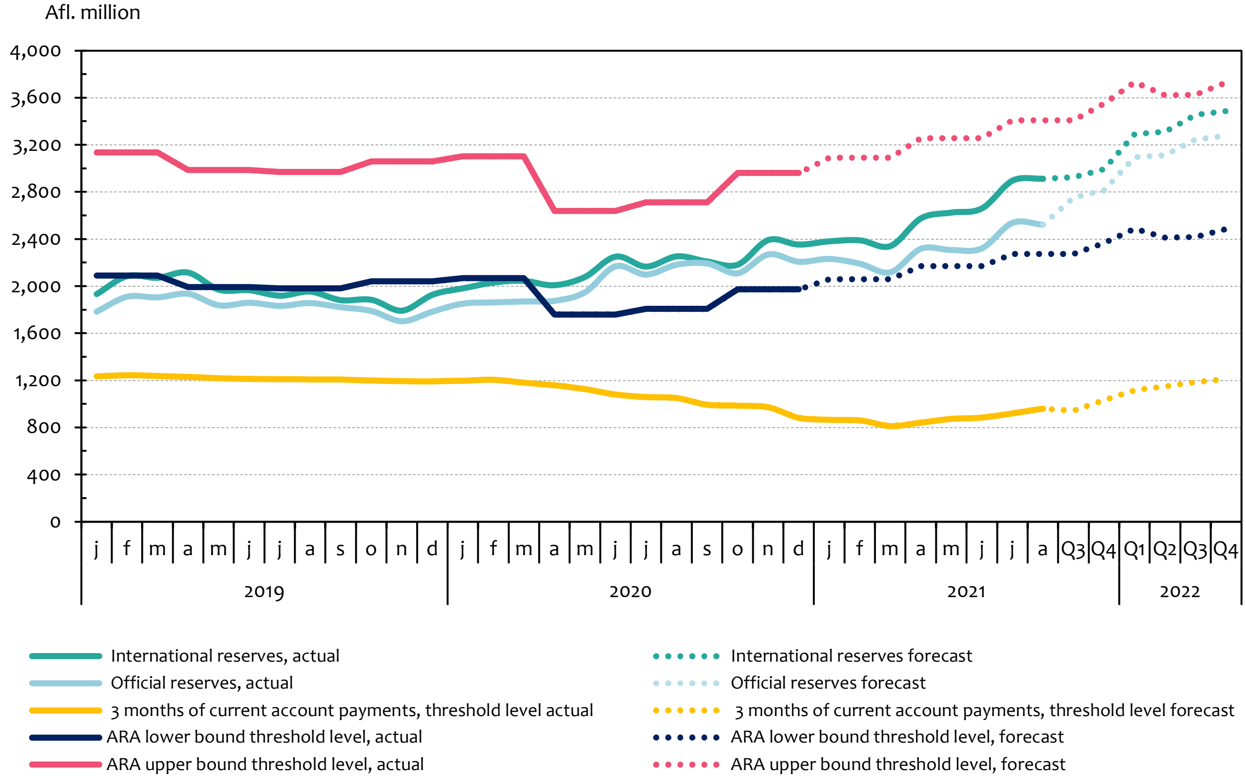
During the first three (3) quarters of 2021, both official and international reserves remained well above the benchmarks used, and, therefore, have proven to be resilient (Table 1). Specifically, official reserves (including the revaluation differences of gold and foreign exchange holdings), up to and including the 24th of September 2021, widened by Afl. 340.8 million in comparison to end-December 2020. Additionally, international reserves expanded by Afl. 566.7 million in the same period, due to the mentioned official reserves expansion and an Afl. 236.1 million rise in foreign exchange reserves of the commercial banks. The observed growth in the official and international reserves was primarily the result of the short-term loans for liquidity purposes provided by the Dutch government to the government of Aruba, as well as higher inflows related to tourism, which picked up substantially since the second quarter of 2021.

Table 1: Reserve benchmarks monitored YTD 2021 (Source: CBA, 2021).

	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
IMF ARA metric (in percent)	108.3	106.3	102.8	106.7	106.3	106.9	111.7	111.0	121.0
CA coverage ratio (in months)	8.3	8.3	8.6	9.2	9.0	9.0	9.4	9.1	9.3

The level of the official and international reserves stood at, respectively, Afl. 2,548.7 million and Afl. 2,923.3 million on the 24th of September 2021 (Graph 1). Accordingly, the IMF ARA metric stood at 121.0 percent as per the end of September 2021, while the CA coverage ratio was calculated at 9.3 months. Thus, at the end of said month, both metrics remained well above the monitored thresholds.

Graph 1. Official- and international reserves (incl. rev. diff.)
Forecast based on baseline scenario (Source: CBA, 2021).

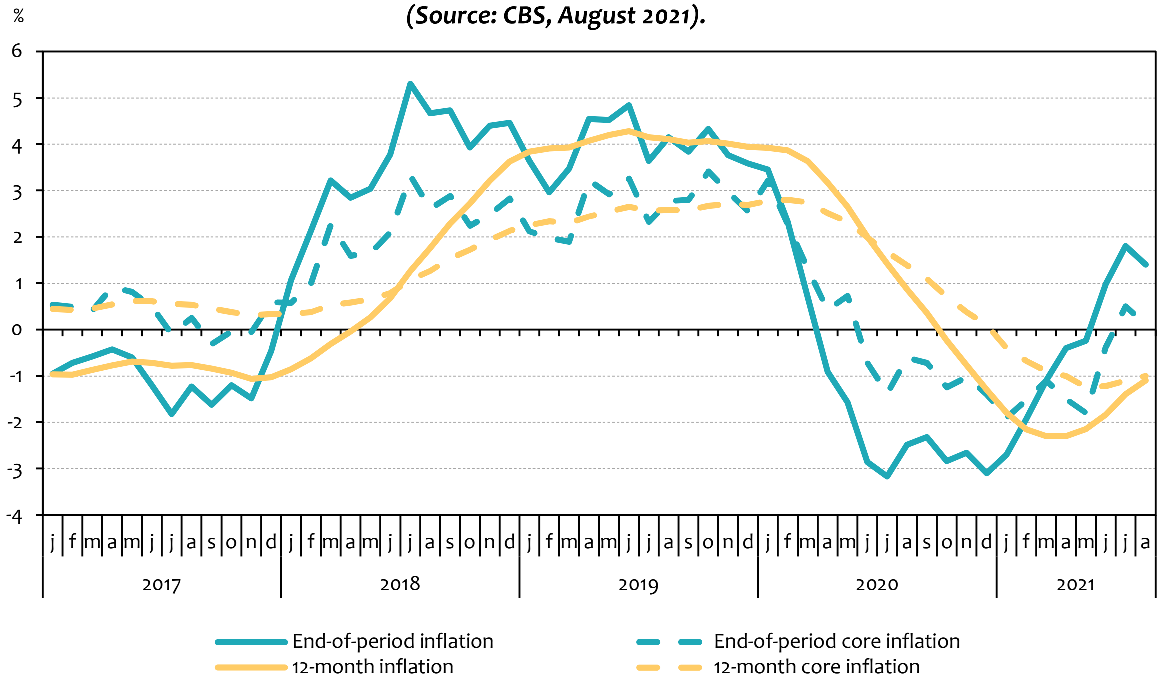


3. Inflation remained trending upwards in August 2021

In August 2021, the CPI index rose by 1.4 percent compared to a year earlier. On balance, this was mainly driven by an increase in gasoline prices, which is part of the transport component of the CPI (the transport component contributed with 1.5 percentage points to the total inflation). Likewise, the component of housing contributed with 0.3 percentage point to the total inflation in August 2021. The latter was mostly the result of increased prices for maintenance and repair of dwellings, and likely driven by the increases in (import) prices of construction, renovation, and maintenance materials. The predicted end-of-period inflation is calculated at 1.9 percent by the end of December 2021 and is foreseen to contract to 1.6 percent by the end of 2022.

The twelve-month average inflation has followed an increasing trend since April 2021 (Graph 2). Consequently, at the end of August 2021, the twelve-month average inflation rate stood at -1.1 percent compared to the lowest point of -2.3 percent registered in April 2021. It is expected that the twelve-month average inflation will accelerate to 0.5 percent by the end of December 2021 and is expected to continue to increase in 2022.

Graph 2. Inflation based on the consumer price index of Aruba
(Source: CBS, August 2021).



4. Upward trend in commercial banks' excess liquidity combined with contracting commercial banks' credit

The excess liquidity of the commercial banks continued its upward trajectory in August 2021, reaching Afl. 1,580.3 million compared to Afl. 1,107.4 million registered in December 2020. In general, excess liquidity has been trending upwards since the first quarter of 2020, mainly as a result of the reductions in the reserve requirement and the minimum prudential liquidity ratios as of March and April 2020, forming part of the monetary and prudential policy relief measures to mitigate the effects of the COVID-19 pandemic.

Moreover, another contributing factor to the continued increase in commercial banks' excess liquidity is the relatively muted demand for credit. Specifically, overall commercial bank credit contracted by 2.2 percent in August 2021 compared to December 2020. The downward movement was mainly caused by declines in business loans (-3.5 percent) and loans to individuals (-1.8 percent). Although an uptick in housing mortgages (+0.2 percent) and in the category 'other' (+0.5 percent) was noted, these were, however, insufficient to offset reductions in the other loan components. The weak demand for commercial bank credit and its subsequent impact on the level of excess liquidity in the commercial banking sector is also likely due to the continued financial support to businesses by the government of Aruba. This is reflected in demand deposits held by businesses, as it increased by 14.1 percent in August 2021 compared to December 2020.

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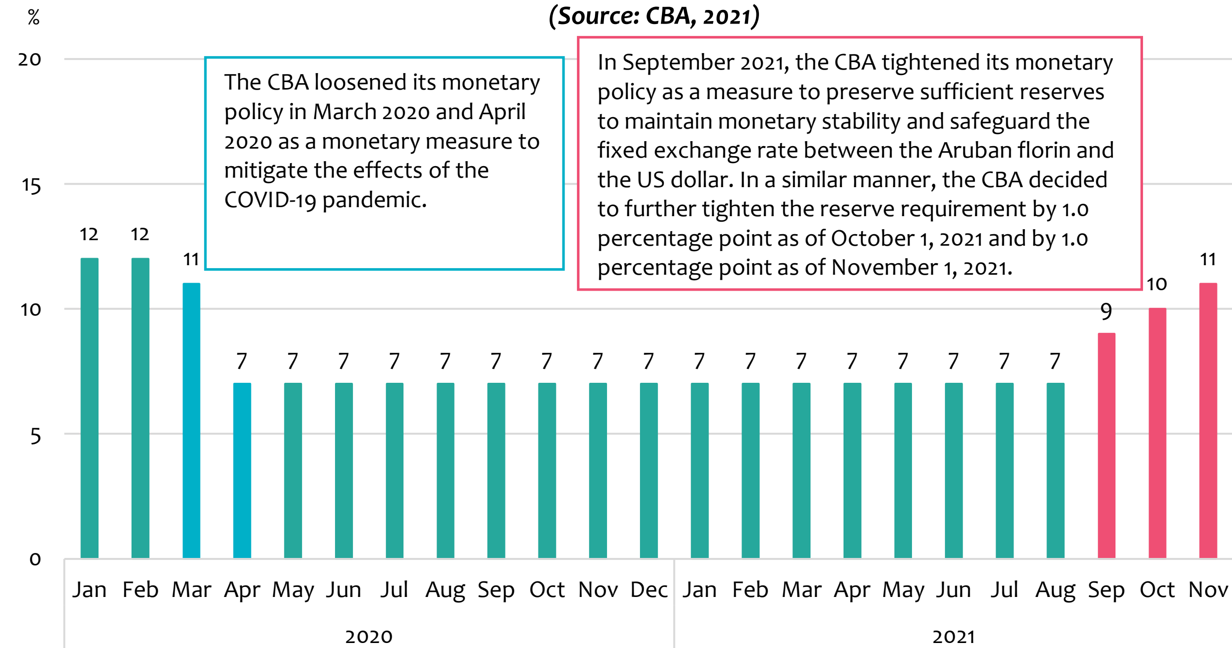
5. Anticipated outflows due to de-escalation initiatives by the CBA

Despite the comfortable level of official and international reserves, the CBA anticipates an increase in foreign exchange payments as a result of the lifting, as per September 2021, of the previously introduced foreign exchange restrictions. The latest forecasts show a total of Afl. 261.8 million to flow out by the end of 2021.

6. Monetary Policy Committee decision on reserve requirement

Considering the ample excess liquidity in the commercial banking sector, the projected uptick in inflation, the continued economic recovery, as well as the anticipated increase in foreign exchange outflows, the Monetary Policy Committee (MPC) of the CBA decided during its meeting of September 14, 2021, to expand the reserve requirement from 9.0 percent to 10.0 percent effective on October 1, 2021 (Graph 3). Motivated by the rising excess liquidity at the commercial banks and the expected outflows related to the full de-escalation of the foreign exchange restrictions, **the MPC determined during its meeting on October 14, 2021, to increase the reserve requirement further by 1 percentage point (i.e., from 10.0 percent to 11.0 percent) as of the 1st of November 2021.**

Graph 3. Reserve Requirement
(Source: CBA, 2021)



December 8, 2021

Oranjestad, Aruba